

E-015/M-90-209 APPROVING CONTRACT

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Darrel L. Peterson	Chair
Cynthia A. Kitlinski	Commissioner
Norma McKanna	Commissioner
Robert J. O'Keefe	Commissioner
Patrice Vick	Commissioner

In the Matter of Minnesota Power's Request
for Approval of an Amendment to the Electric
Service Agreement of USX Corporation

ISSUE DATE: October 5, 1990

DOCKET NO. E-015/M-90-209

ORDER APPROVING CONTRACT

PROCEDURAL HISTORY

On April 2, 1990, Minnesota Power (MP) filed a petition seeking Commission approval of an amendment to its electric service agreement with USX Corporation (USX). USX and MP had settled on a proposal to extend their existing contract in exchange for a cash payment.

On July 13, 1990, the Department of Public Service (the Department) filed a report recommending that the Commission disapprove the proposed amendment. MP filed a response to the Department's report on July 26, 1990. The Department in turn filed responsive comments on August 2, 1990.

On August 9, 1990, National Steel Corporation, Eveleth Expansion Company and Eveleth Taconite Company, Inland Steel Mining Company and Hibbing Taconite Joint Venture (the Other Taconites) filed joint comments in support of the proposed USX/MP amendment. USX also filed comments in support of the proposed amendment on August 9, 1990.

MP filed its final reply on August 10, 1990.

The matter came before the Commission on August 30, 1990.

FINDINGS AND CONCLUSIONS

HISTORICAL BACKGROUND

MP Large Power Customers

The Large Power (LP) class is designed for customers with demands of 10 MW or greater. USX and the Other Taconites are the five taconite companies in MP's LP class. The class also includes four paper companies.

Electric Service Agreements

Both the taconite and the paper industries have special energy demands. They are energy-intensive and highly sensitive to fluctuations in world trade. MP, which is largely focused on these two volatile industries, has sought means of stabilizing energy supply and demand.

In the 1970's a practice of negotiating individual electric service agreements between each LP customer and MP evolved. Under these agreements, LP customers commit to take specified amounts of power for specified time periods (take-or-pay commitments), in exchange for a secure source of power. The LP customers are thus assured of the availability of power at the quantity contracted for, and MP is able to project what investment and construction will be necessary to meet future energy demands.

On March 11, 1975, MP and USX entered into an electric service agreement.

Economic Downturn in the 1980's

In the 1980's the American steel industry suffered a severe economic downturn. Taconite pellet production was cut back, and energy demand was greatly reduced. Taconite companies were faced with commitments to pay for energy which would not be needed.

Recognizing the change in circumstances, MP and its LP customers, including USX, negotiated amendments to their electric service agreements. MP allowed the financially pressed customers to reduce their energy commitments. In exchange, the customers agreed to extend the termination dates of their initial contracts. As an added feature to the renegotiated contracts, MP allowed LP customers to take power above their new commitments, when needed, without making long-term commitments for this "excess" power. The renegotiated contracts were approved by the Commission.

MP Rate Case

In 1987 MP filed for a general rate increase in Docket No.

E-015/GR-87-223. As a result of this proceeding, a special rate for excess power was added to the LP tariff. Large Power customers were given a \$5.00 per kW discount on all power requirements in excess of their take-or-pay commitments. The Commission approved the excess demand discount because it would encourage LP customers to increase production in a time of abundant production capacity. Customers would receive a favorable price and MP would be able to derive revenues from excess capacity that would otherwise remain idle.

1989 Proposed Contract Amendment

On July 11, 1989, MP filed a Petition to amend its electric service agreement with USX in Docket No. E-015/M-89-512. The proposed amendment would have offered USX a discount on excess power in exchange for short-term commitments on the excess power. The Department recommended disapproval of the proposed amendment because it did not contribute to long-term revenue stability for MP or its ratepayer.

On February 27, 1990, the Commission issued its ORDER DENYING PETITION WITHOUT PREJUDICE, in which it denied MP's petition for an amendment to its electric service agreement with USX. The Commission based its decision on the following factors: allowing individual customers to take power at non-tariffed rates ran counter to standard regulatory policy; the Company's surplus capacity was dwindling; and the proposed rate could jeopardize retirement of the AFPO account.

MP'S CURRENT PROPOSED AMENDMENT TO ITS ELECTRIC SERVICE AGREEMENT WITH USX

As a result of their latest negotiations, MP and USX have proposed an extension of their electric service agreement by eight months, from January 1, 1995 to August 31, 1995. Under the proposal, the current take-or-pay commitment of 161 MW would be reduced to 80 MW during the contract extension period. USX would also commit to the following schedule for purchasing excess power in 1990:

January	32.6 MW
February	32.87 MW
March-April	30.5 MW
May-September	24.0 MW
October-December	30.5 MW

MP would price the excess energy at the "firm energy" rate, rather than the incremental rate. This would represent a small discount on the energy charge. The amendment, if implemented, would be effective from January, 1990.

In exchange for the commitments agreed to by USX in the proposal, MP would pay USX a cash payment of \$1.7 million.

THE DEPARTMENT RECOMMENDATION

The Department reviewed the USX/MP proposal and concluded that it is not in the best interests of MP ratepayers. According to the Department, the proposed amendment does not contribute to the utility's long-term revenue stability and thus should be rejected. The Department's calculation of long-term revenue stability is based on the size of the contract commitment in relation to the customer's current take-or-pay commitment, and the length of the contract extension. The Department found the USX/MP proposal wanting in both respects. USX's demand level would be reduced from its current size, and the contract extension would be for less than a year. For these

reasons, the Department recommended denying the proposed amendment.

COMMISSION ACTION

While the Commission sees merit in the Department's long-term revenue analysis, there are occasions in which other factors outweigh this method. In this case, a contract extension of eight months, plus a revenue increase of \$3.7 million from sale of incremental power, add up to significant revenue enhancement for MP. The cost-benefit ratio of .16 is favorable. The reduction in demand level from the current full-capacity level of 161 MW to 80 MW merely brings USX in line with other LP customers, who are also committed to less than full-capacity levels.

The current USX/MP proposal can be distinguished from the 1989 proposal which was denied. Here no flexible rate will be offered; tariffed rates will be applied. There is no issue of intraclass discrimination, since all MP customers of the LP class are being offered similar contracts. The Company's surplus capacity is not currently dwindling. Finally, the AFPO account will not be affected adversely.

Judged overall, the proposed amendment to the USX/MP service area agreement is of benefit to MP ratepayers and to MP and USX shareholders. The Commission will approve the proposal.

While the Commission will approve the proposed USX/MP amendment, the Commission shares a Department concern regarding the excess demand discount. As discussed previously, this discount first came into effect during the 1987 MP rate case, when MP was experiencing a time of abundant capacity. The discount was partially an incentive to promote increased customer usage. Since that time, MP's capacity level has decreased, both as a result of the sale of capacity to other utilities and to increased service to LP customers. While the Commission finds that the excess demand discount is still justified in this particular set of facts, it may be necessary to consider elimination of the excess demand discount at some future time.

The Commission is also greatly concerned about the effects on MP ratepayers of the large cash payment to USX. The Commission has approved the payment as part of an overall negotiated contract which is generally favorable to MP ratepayers as well as to USX and MP shareholders. In approving the cash payment, however, the Commission is not expressing any indication of its treatment of this issue in future rate proceedings. Any ratemaking issues raised by MP due to the cash payment will be examined closely at the time of the rate proceeding.

ORDER

1. Minnesota Power's April 2, 1990 petition requesting an amendment to the USX/Minnesota Power electric service agreement is hereby approved.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)